June 25, 2002
DECISION AND ORDER
OF THE DEPARTMENT OF ENERGY

Appeal

Name of Petitioner: State of Washington

Date of Filing: April 26, 1999

Case Number: VPA-0001

This determination will consider an Appeal filed with the Office of Hearings and Appeals (OHA) on April 26, 1999, by the State of Washington's Department of Revenue under the Notice of Interpretation and Procedures (NOIP) implementing the "payments-equal-to-taxes" (PETT) provision in section 116(c)(3) of the Nuclear Waste Policy Act of 1982, (NWPA), 42 U.S.C. § 10101 *et seq*. Under the NOIP, the Department of Energy (DOE) will grant, to a State in which a candidate site for a high-level nuclear waste repository is located, a payment equal to the amount that State would receive if it were authorized to tax site characterization activities at that site. *See* 56 Fed. Reg. 42314 (August 27, 1991). The payment authorized by the NWPA is known as a "PETT grant." The history of the PETT program and the Basalt Waste Isolation Project and Near Surface Test Facility (collectively referred to as the BWIP) for characterization of a candidate site for a repository on the Hanford reservation in Washington State is described at length in Benton County, Washington, 26 DOE ¶ 80,145 (1996), http://www.oha.doe.gov/cases/pett/lpa0001.htm.

On February 24, 1993, the State submitted a formal claim to the DOE's Richland Operations Office for a PETT grant equal to the taxes it would have levied for site characterization activities at Hanford. By letter dated March 23, 1999, DOE's Office of Civilian Radioactive Waste Management (RW) denied the State's claim for a PETT grant based on Washington's Business and Occupation ("B&O") Tax. The amount in controversy is substantial; with interest through March 30, 2001, the State calculated the value of its claim as $14,096,589. State's Hearing Exhibit 6.

The fundamental dispute between the State and RW can be summarized as follows: According to the State, the B&O tax is Washington's principal tax on business activities. It is based on a taxpayer's gross income, and it is intended to reach all business activity within Washington State. Since the BWIP was a Federal project funded through the DOE, it did not have any gross income, and the State based its PETT claim on "the most comparable surrogate, the amount of expenditures associated with site characterization at Hanford." Petitioner's Statement of Position at 7. The State asserts that unless the BWIP is analogized to a private firm performing site characterization activities

for hire, the PETT provision in section 116(c)(3) is rendered meaningless. RW maintains that since the BWIP had no gross income, its site characterization activities could not form the basis for taxation under the Washington B&O tax, and no PETT grant is due. RW also contends that the State cannot use the BWIP budget expenditures as a surrogate for gross income because that is not normally done under Washington tax practice. RW further contends that it is more appropriate to analogize the BWIP expenditures to "interdepartmental charges," in the nature of purely financial transfers from one branch of a hypothetical foreign corporation to another branch doing site characterization "in its own backyard" on land owned by the parent in Washington State. According to RW, such interdepartmental charges would be exempt from the B&O tax under Washington State law, and no PETT would be due.

I. Background

A. The Nuclear Waste Policy Act of 1982, as amended

A principal purpose of the NWPA was to provide for the development of a geologic repository for the permanent storage of high-level radioactive waste and spent nuclear fuel. As originally enacted, section 112(b) of the NWPA directed the Secretary of Energy to recommend three candidate sites for the repository to the President. Section 112(c) required approval by the President of these sites. Under these provisions, the Secretary recommended sites in Washington State (BWIP), Nevada (Yucca Mountain), and Texas (Deaf Smith County). On May 28, 1986, the President accepted the Secretary's recommendation and approved these sites. Section 113(a) directed the Secretary to carry out site characterization "beginning with the candidate sites that have been approved under section 112." Section 116(c)(3) of the NWPA directed the DOE to make PETT grants to the state and local governments in which potential repository sites were located:

> The Secretary shall also grant to each State and unit of general local government in which a site for a repository is approved under section 112(c) an amount each fiscal year equal to the amount such State and unit of general local government, respectively, would receive were they authorized to tax such site characterization activities at such site, and the development and operation of such repository, as such State and unit of general local government tax other real property and industrial activities occurring with such State and unit of general local government. Such grants shall continue until such time as all such activities, development, and operation are terminated at such site.

42 U.S.C. § 10136(c)(3) (emphasis added). PETT grants were to be paid from the Nuclear Waste Fund. 42 U.S.C. § 10136(c)(5).

Only 18 months after the President approved the BWIP as a candidate site for the repository, Congress enacted the NWPA Amendments of 1987 in Title V of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203. This legislation narrowed the search for a repository site by designating the Yucca Mountain site under section 112 of the NWPA as the sole candidate for characterization in accordance with section 113, 42 U.S.C. § 10133. DOE was directed to terminate

all site characterization activities at the BWIP within 90 days after December 22, 1987, the date on which the NWPA Amendments of 1987 were signed into law. 42 U.S.C. § 10172.

The 1987 amendments made other, conforming changes in the NWPA that are relevant to a contested issue in the present appeal, namely the termination date for Washington's PETT eligibility. As originally enacted, section 116 provided for participation of "States with one or more potentially acceptable sites for a repository" in a public process leading to the final selection of a repository site. Sections 116(c)(1) and (c)(2) provided for "financial assistance" grants to enable the States to participate in the selection process. 42 U.S.C. § 10136. Those financial assistance grants to the States were distinct from PETT grants and had a different purpose from the PETT grants contemplated by section 116(c)(3), and the statute as originally enacted stated that payments equal to taxes were *in addition to* financial assistance grants by beginning the PETT provision with the phrase "The Secretary shall also grant to each State...." When the 1987 amendments limited site characterization to Yucca Mountain, the language of section 116 was modified by deleting the general references to "States" and substituting specific references to "the State of Nevada." That word change recognized that henceforth, Nevada would be the only State entitled to receive financial assistance grants for participating in the repository selection process, and PETT grants for site characterization activities (and the possible development and operation of a repository). The PETT provision in section 116(c)(3)(A) of the amended statute begins with the phrase, "In addition to the financial assistance grants under paragraphs (1) and (2), the Secretary shall grant to the State of Nevada...." Finally, a new paragraph (6) was added to section 116(c) which provides that "No State, other than the State of Nevada, may receive financial assistance under this subsection after December 22, 1987." 42 U.S.C. § 10136(c)(6)(emphasis added).

B. DOE's Notice of Interpretation and Procedures

In August 1991, RW issued a final Notice of Interpretation and Procedures (NOIP) for administering the PETT provisions of the NWPA, as amended. 56 Fed. Reg. 42314 (August 27, 1991). The final NOIP addressed comments received in response to a Proposed Notice issued on March 7, 1990. Several of the changes adopted in response to those comments are relevant to the present case. First, the interpretation of "site" was expanded to include all site characterization activities associated with a candidate site coextensive with the taxing jurisdiction's taxing authority, whether or not those activities are conducted on the physical site. In the present case this means that all site characterization-related activities subject to taxation by the State of Washington are eligible for inclusion in the State's PETT claim, no matter where those activities occurred. *Id*. at 42316. Second, the NOIP provided for an appeal process through the OHA for those jurisdictions having disputes with RW regarding PETT, and stated that OHA's decision on an appeal will serve as the final DOE action with respect to PETT. *Id*. at 42317. Finally, the NOIP considered comments about the commencement and termination of PETT eligibility. The NOIP determined that the State's eligibility for PETT would begin on May 28, 1986, the date on which the President approved the three candidate sites, and end on December 22, 1987, the date of enactment for the NWPA Amendments of 1987. In addition, the NOIP established the administrative procedures for considering PETT claims. *See* 56 Fed. Reg. 42318-20.

In setting the time limits for the State's PETT eligibility, the NOIP considered comments submitted by the State of Washington and the Mid-Columbia Consortium of Governments. These commenters claimed that DOE's proposed selection of May 28, 1986 as the commencement date for PETT eligibility was unreasonable, since site characterization activities were underway at the BWIP before it was formally recommended for site characterization under the NWPA procedures. After considering these comments, DOE determined that the preliminary activities undertaken before any site was designated as a "candidate site" under the NWPA did not constitute "site characterization" within the meaning of section 2(21) of the NWPA. In reaching that determination, DOE pointed out that the term "site characterization" is defined as:

> (A) siting research activities with respect to a test and evaluation facility at a candidate site; and (B) activities, whether in the laboratory or in the field, undertaken to establish the geologic condition and the ranges of the parameters of a candidate site relevant to the location of a repository, including borings, surface excavations, excavations of exploratory shafts, limited subsurface lateral excavations and borings, and in situ testing needed to evaluate the suitability of a candidate site for the location of a repository, but not including preliminary borings and geophysical testing needed to assess whether site characterization should be undertaken.

42 U.S.C. § 101(21). The NOIP explained that although various laboratory and field activities may have been underway at the sites prior to May 28, 1986, "these activities were neither related to a test and evaluation facility nor were they undertaken to establish the geologic condition or ranges of the parameters relevant to the location of repository." 56 Fed. Reg. at 42318. The NOIP goes on to state that "[e]ven if some of the data collected before the May 28, 1986 date were relevant to the overall characterization of the site, that fact alone would not qualify the data collection process as 'site characterization' for purposes of the NWPA." *Id*.

In addition to setting the time limits that apply to the State, the NOIP specified the following general requirements for a jurisdiction to be eligible to receive PETT payments for site characterization activities: (i) the jurisdiction must have the requisite taxing authority, and (ii) the jurisdiction must levy taxes applicable to non-Federal activities that are similar to the site characterization activities conducted by the Federal Government. *Id*. at 42318.

Based on the definition of site characterization in section 2(21) of the NWPA, the NOIP determined that the following types of activities would be eligible for PETT: (i) activities that impact the assessed value of real property; (ii) activities carried out prior to May 28, 1986, but only to the extent that the residual value of these activities after May 28, 1986 is treated as improvements to real property, used in support of site characterization for purposes of assessment valuation; (iii) ownership or possessory use of personal property; (iv) purchase or transfer of personal property acquired in one State for use in an eligible State; (v) use of motor vehicles; (vi) use of special fuels; (vii) payment of salaries to Federal employees; and (viii) activities subject to business or income taxes. The preceding list is not exclusive, and the NOIP recognized that other activities undertaken

by DOE to evaluate the geologic suitability of the site that an eligible jurisdiction is authorized to tax may also be considered in the calculation of PETT. *Id*.

The "Administrative Procedures" section of the NOIP described the "estimated PETT analysis" that the eligible jurisdictions should submit to the DOE. For the period concerned in the present Appeal, only two state governments were eligible to submit estimates for PETT payments: Nevada, for the Yucca Mountain site, and Washington, for the Hanford site. According to the NOIP, the estimated PETT analysis should include the following:

> 1. Basis for eligibility showing how the jurisdiction meets the requirement for eligibility as set forth in this Notice. 2. Citations of relevant tax rules, regulations, rates, and bases for applying the rates. 3. Lists of Federal site characterization activities considered in estimating the PETT. 4. Calculations supporting the estimates in sufficient detail to allow DOE to verify the estimates. 5. Estimate of PETT liability for each tax type to which DOE's site characterization activities are subject and estimates of PETT liability for each tax type in accordance with the appropriate tax laws.

Id. at 42319. The NOIP states that DOE will review these analyses to verify that they are complete and correct regarding DOE's site characterization activities, the assessed value of DOE's property used to support its site characterization activities, DOE's operational activities subject to tax, and the tax laws of the eligible jurisdiction. The Notice provides that "late payments shall include interest, if appropriate, in accordance with applicable requirements of the taxing jurisdiction." *Id*.

II. Positions of the Parties

A. The State's PETT Estimate

The State submitted its PETT claim to DOE/RL on February 24, 1993. The claim was based on several types of taxes that Washington collects. At this point, RW has granted the claim in part and paid Washington a PETT grant based on all applicable taxes but one, the B&O tax, which is the focus of the present appeal. The claim stated that the B&O tax is Washington's principal tax upon business activities, citing Revised Code of Washington (Wash. Rev. Code) 82.04.220, and noted that the tax is based on "the gross income of the business," as that term is defined in Wash. Rev. Code 82.04.280. The claim continued that "for PETT purposes there are no 'sales' or 'income' comparable to the private sector meaning of gross receipts." The State determined that the closest approximation of gross income is the amount of expenditures associated with the BWIP site characterization, and used these amounts as a measure of the B&O tax liability for PETT purposes. The State separated its PETT claim into two periods. The first period was for January 7, 1983 until May 28, 1986. For this period, the State sought B&O tax of $3,330,520, plus interest through December 31, 1992. The second period covered by the State's claim was for May 28, 1986 until December 22, 1987. For that period, the State sought B&O tax of $2,895,227, plus interest through December 31, 1992. The updated amounts for the two periods claimed by the State, including

interest through September 30, 1998, were $7,321,166 (for the period January 7, 1983 to May 28, 1986) and $5,672,528 (for the period May 28, 1986 though December 22, 1987).

B. RW's Determination

On March 23, 1999, RW issued a determination denying the State's claim for a PETT grant based on the B&O tax. This determination rejected the State's PETT estimate for several reasons. First, RW read Wash. Rev. Code 82.04.290 as suggesting that an ordinary Washington business with "no gross income" would pay zero B&O tax. Determination at 4. Second, RW found no legal authority for the State's substitution of its own "approximation" for gross income in cases where gross income is zero, noting that the State's PETT estimate had submitted no examples of other taxpayers who paid B&O tax on the basis of an approximation of gross income. *Id*. Third, RW determined that the DOE's BWIP budget was the equivalent of an interdepartmental charge, furnished by one branch of a business organization to another department or branch. Under Washington Administrative Code (WAC) 458-20-201, amounts representing interdepartmental charges are excluded in computing the amount due for B&O tax. RW observed that Washington could have subjected interdepartmental charges to the B&O tax, but the legislature deliberately determined not to subject a purely financial transaction, such as the transfer of funds from one corporate department to another, to the B&O tax, *citing* Washington Excise Tax Bulletin 86.04.201.203 issued July 22, 1986. RW's determination reasoned that:

> Since Section 116(c)(3) requires that site characterization activities be subject to the same taxation rules as are all Washington businesses, the interdepartmental charge exemption to the B&O tax must also be applied to site characterization activities. Accordingly, a simple allocation of funds from one branch or department of the Federal government to another, i.e. from President and Congress to the [DOE] and the BWIP project, is not the type of transaction that would be taxed under Washington law, and thus may not form the basis for a PETT grant.

Determination at 5.

RW's determination then summarized its fundamental reasons for rejecting the claim:

> In order to establish a basis for the B&O tax, the [State] would postulate a fictional transaction in place of the transaction which actually occurred, and then apply the B&O tax to the fictional transaction. However, we have found no basis in Washington tax law for the use of legal fictions of this nature in determinating the amount of B&O tax due. Such a legal fiction could well form the basis for a PETT grant if it were shown to be a regular part of Washington tax practice, applicable to all industrial taxpayers. However, our study of Washington tax law indicates that the term "gross income" is construed strictly in accordance with the statutory definitions. Since Congress requires that PETT be determined in accordance with the same rules applicable to all taxpayers, we must use the standard definition of gross income.

Id. The determination also addressed two other issues that the State raised: an issue concerning RW's characterization of the BWIP budget as an "interdepartmental charge," and an issue concerning the "pyramiding" of the B&O tax. The State had argued that "to conclude that DOE was merely a department of a larger corporation would render the grant language of Section 116(c)(3) virtually meaningless, if not entirely meaningless." *Id*. at 6, *quoting* the State's July 27, 1998 letter. RW asserted that the State's foregoing argument "would have more weight if the B&O tax were the only one which could support a PETT grant." However, RW noted that it had previously determined that the State was eligible for PETT concerning the Tax for Common Schools, and also the State Use Tax, and that "these determinations give substantial meaning to Section 116(c)(3)." RW reiterated that departments of larger corporations in Washington State regularly receive transfers of money from corporate treasuries without the payment of B&O taxes on these transfers, and that the State "would have us render 'entirely meaningless' the fundamental congressional intent underlying Section 116(c)(3): the concept that payments are to be 'equal' to taxes." *Id*.

The RW determination noted that the PETT grant claimed by the State would be "pyramided" upon the B&O taxes already collected from BWIP contractors who did the bulk of project work. Since the State has already collected "a full portion of B&O tax from this source," RW "saw no need to adopt a strained reading of Section 116(c)(3) merely to add 'meaning' to this provision." According to RW, "the best interpretation of Section 116(c)(3) would have us calculate the B&O tax for PETT purposes exactly as [the State] would apply the tax to private, industrial taxpayers." *Id*.

In view of RW's decision to reject the B&O tax claim since the BWIP had no gross income, and in view of its characterization of the BWIP budget as purely financial interdepartmental charges exempted by the legislature from the B&O tax, the Determination declined to consider various other issues, such as the exact calculation of such a tax, and the particular tax rate that should be applied. *Id*. Finally, the Determination did not address the issue of the time periods for which Washington State would be eligible for PETT. However, RW has argued in the present appeal that the State's PETT eligibility, if any, ran from May 28, 1986 (when the President designated the BWIP as a candidate site) through December 22, 1987 (when the NWPA amendments were signed into law).

C. Washington State's Contentions on Appeal

The State contends that RW's Determination erred in denying its PETT claim for B&O tax. The State begins by describing what it characterizes as the "pervasive"nature of the B&O tax. In response to RW's Determination, the State gives examples of nonprofit associations and municipal governmental entities that have been assessed B&O tax on activities undertaken for public benefits other than profits, and examples of private firms that have been assessed B&O tax based on their actual costs, even when their accounting systems did not yield gross receipts, or gross income in the usual sense. Then the State goes on to explain why it believes that section 116(c)(3) must be read in conjunction with the Washington taxation scheme to authorize a PETT grant based on the B&O tax. The State rejects RW's alternative theory that analogizes the BWIP budget expenditures to "interdepartmental charges" transferred from one branch of a hypothetical foreign corporation to fund site characterization activities by its Washington State branch on its own land. Finally, the

State addresses the rate of taxation that it contends is appropriate for the BWIP site characterization, and the time periods for which it contends PETT should be granted. Each of these arguments is addressed below.

The State contends that making a profit is not required before the B&O tax is imposed, and notes that the Washington Supreme Court has rejected arguments made by nonprofit associations and municipal governments that they were not engaged in business because their activities did not benefit themselves or their members monetarily. Petitioner's Statement of Position at 4, *citing Young Men's Christian Ass'n v. State*, 62 Wash.2d 504, 508, 383 P.2d 497 (1963) (the B&O tax applies to all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly), *Seattle v. State*, 59 Wash.2d 150, 367 P.2d 123 (1961) (the legislature did not intend to restrict meaning of the term "business" to those activities engaged in solely for profit), and *Tacoma v. State Tax Comm'n*, 177 Wash. 604, 33 P.2d 899 (1934) (the legislature intended to tax activities engaged in with the object of nonmonetary benefit).

The State further argues that the mere fact that the amount received by a taxpayer only equals its costs is not controlling for B&O tax purposes. Petitioner's Statement of Position at 4. In support of this point, the State cites the case of *Pullman Co. v. State*, 65 Wash.2d 860, 400 P.2d 91 (1965), in which the Washington Supreme Court held that even though the payments Pullman received for repairing and maintaining railroad cars owned by other entities were intended to represent a reimbursement for the actual costs and yielded no profit to Pullman under its accounting scheme, they became taxable as part of the gross income derived from "retailing" under the B&O tax. In addition, the State cites Washington court decisions holding that deductions, exemptions, and even the terminology used by the legislature in the B&O tax statutes are to be narrowly construed to fulfill the legislative intent to make it a pervasive tax.

In its Answers to RW's Requests for Admission, the State also cited a case decided by the Washington Board of Tax Appeals in which the Department of Revenue (DOR) was required to determine a taxable value for products for which there was no "sale" or "income." *Shell Oil Co. v. State of Washington, Dep't of Rev.*, BTA No. 93-28 (May 23, 1997) (*Shell*). The primary issue in that case was how to value exchanged petroleum products for purposes of the B&O tax. During the tax years at issue, the taxpayer participated in large volume exchanges with other refiners. This practice involves a transaction where one party delivers barrels of product to the exchange partner and receives back a like amount of barrels at another place and time. In Shell's case, generally no money changes hands in these exchanges, but the value of the exchanged products is fully taxable under the B&O tax unless the exchange qualifies as an exempt accommodation sale under Wash. Rev. Code § 82.04.425. Shell's exchanges did not qualify for that exemption, and they were subject to B&O tax on the market value of the products given up in the exchange as the DOR determined by reference to *Platt's*, an industry standard oil price reporting service. *Shell, supra*. That valuation is similar to imputing a total revenue to the value of the exchange at the time the products were made available to the exchange partner.

The State also argues that the language of section 116(c)(3) provides a basis for the granting of PETT. According to the State, the PETT statute "further provides that the amount to be paid shall

be equivalent to what the State would receive from a taxable entity engaging in industrial activity within the State." In the State's view,

> the appropriate analogy, therefore, is to liken USDOE to a general contractor performing work for the federal government which is paid a given amount for work it will perform itself, with or without the assistant of subcontractors. To analogize USDOE to an independent contractor gives meaning to § 116(c)(3). Otherwise, the language granting PETT to states in the amount they would receive were they authorized to tax site characterization activities at the federal site really is meaningless.

Petitioner's Statement of Position at 7. The State also asserts that under Wash. Rev. Code 82.04.290, such site characterization activities would be subject to the "catch-all" rate of tax for "other business and service activities." *Id*. The State asserts that "pyramiding" of tax burdens is a significant feature of the B&O tax, so that even if the BWIP subcontractors have already paid B&O tax on the amounts they received from DOE, the BWIP itself as the general contractor in the State's analogy, would have to pay B&O tax based on its gross income. *Id*. at 2, 3.

III. OHA Procedural History

After the present Appeal was filed on April 26, 1999, OHA requested that each party submit a statement setting forth its position in detail. Following the exchange of these Statements of Position, a series of status conferences were held by telephone during the next several months, and the parties conducted discovery. OHA issued one interlocutory decision to resolve discovery issues. *State of Washington*, 27 DOE ¶ 82,503 (200). We explored the possibility of avoiding an evidentiary hearing and proceeding directly to decide the case on cross motions for summary judgment. However, we ultimately determined that since certain fundamental facts remained in dispute, it would be necessary to hold an evidentiary hearing in order to develop a complete record.

Shortly before the evidentiary hearing, OHA issued a second interlocutory decision in which we denied two motions for partial summary judgment that were filed by RW. *State of Washington*, 28 DOE ¶ 82,501 (2001). The first motion sought partial summary judgment on the following legal proposition: "that a private taxpayer, operating in a similar factual context, would not be subject to B&O tax under Washington law." *Motion* at 1. RW's motion was based on the responses of two State witnesses, David J. Wiest and Kenneth Capek, to hypothetical questions posed to them in depositions by RW's counsel, and the State's answers to RW's requests for admissions. The State disputed RW's characterization of the BWIP project in those hypothetical questions as "a private taxpayer in Washington, who, on its own behalf and using its own money, does site characterization work in its own backyard to determine the yard's suitability for some future purpose." 28 DOE ¶ 82,501 at 85,002. According to the State, "under an equally plausible characterization of the BWIP, gross revenues derived by a company performing site characterization activities for another are indisputably subject to B&O tax" under Washington law. *Id*. The State argued that RW's interpretation of the NWPA's PETT provision would produce a result (no PETT grant for B&O tax on industrial activities at the BWIP during site characterization) that is inconsistent with both Congressional intent and RW's own interpretation of the NWPA in the NOIP. We indicated that we

agreed with the State that RW postulated an analogy that would yield the result which it advocates, but that RW's analogy does not comport exactly with the facts. We therefore denied the first motion for partial summary judgment based on our finding that there is a material dispute about which party's characterization of the BWIP is more appropriate under the circumstances of this case.

RW's second motion sought partial summary judgment on the following proposition: "that the time period for measuring the Petitioner's entitlement for payments equal to taxes (PETT) under section 116(c)(3) of the Nuclear Waste Policy Act (NWPA) commenced on May 28, 1986, and ended on December 22, 1987." *Motion* at 1. RW pointed out that in the *Benton County* decision, OHA had determined that PETT eligibility did not begin until May 28, 1986 when the BWIP was approved as a candidate site under section 112(b) of the NWPA. *See* 26 DOE ¶ 80,145 at 80,618. OHA agreed with RW's position on the start date for PETT eligibility, but we disagreed with RW on the termination date. OHA ruled in the *Benton County* decision that the termination date for PETT eligibility should be March 21, 1988, the effective termination date for BWIP site characterization activities according to the NWPA amendments of 1987. That statute, codified at 42 U.S.C. § 10172, directed DOE to terminate all site characterization activities at the BWIP 90 days after December 22, 1987. Section 116(c)(3) of the NWPA as originally enacted specifies that PETT grants "shall continue until such time as all [site characterization] activities are terminated at such site." 26 DOE ¶ 80,145 at 80,619. Based on our determination that the premise of the second motion was half right and half wrong, we denied that motion as well. 28 DOE ¶ 82,501 at 85,003. RW moved for reconsideration of our decision denying the second motion for partial summary judgment, arguing that section 116(c)(6), which was added by the 1987 NWPA amendments, precluded further "financial assistance" to any State "other than the State of Nevada." We declined to consider the request on the eve of the evidentiary hearing. However, we will consider RW's argument based on the language of section 116(c)(6) later in the present decision.

An evidentiary hearing was held in Seattle on March 28 and 29, 2001. Post-hearing briefs were submitted in August 2001, and reply briefs were submitted in October 2001. In November 2001, after reviewing the entire record, OHA informed the parties that we were prepared to issue a decision without oral argument. This determination was based on our observation that after preliminary briefing, a lengthy discovery process, expert witness statements, a two-day evidentiary hearing, post hearing submissions, and two rounds of post-hearing briefs, the dispute in this case was clearly delineated, and both parties had repeated opportunities to state their respective positions and to challenge each other's theory of the case. RW requested leave to file a rejoinder brief, and the State opposed this request. In December 2001, OHA denied RW's request to file a rejoinder brief, and we took the case under advisement.

IV. Analysis

Under the NOIP, the burden of proof in this case is on Washington State as the applicant for a PETT grant. To prevail in this appeal, the State must show that RW's Determination was erroneous. In that regard, we will begin by considering whether RW erred in its application of the PETT statute to the facts of this case by determining that the State should receive no PETT for the B&O tax. In the papers it filed before the hearing, RW gave two alternative reasons to justify its denial of PETT

for the B&O tax: (1) the BWIP had no gross income, or (2) the BWIP should be analogized to a division of a foreign (i.e. out-of-state) corporation performing site characterization on land owned by its parent in Washington, funded by an interdepartmental transfer payment, which would be exempt from the B&O tax. Both RW and the State have extensively briefed their respective positions on how the PETT grant provision should be applied to the BWIP.

If we find that RW erred in denying the State's PETT claim, we will then consider whether and to what extent we agree with the State that section 116(c)(3) requires RW to analogize the BWIP to a private general contractor performing site characterization for profit, and that the State's use of the BWIP budget expenditures as a surrogate for the gross income of the BWIP is appropriate for PETT purposes. In reaching an answer to the latter questions, we will utilize the expert testimony and documentary evidence submitted at the evidentiary hearing in this matter.

A. Whether RW erred in its application of the PETT statute to the facts of this case

We start from the proposition that RW's views will be sustained unless the State shows that RW's legal fictions and its position are erroneous. After considering the record, we conclude the State has met its burden by showing that RW erred in its application of the PETT statute to the facts of this case. As explained below, we find that the statutory language and the legislative history of the NWPA's PETT provision, RW's interpretation in the NOIP of the PETT provision, the principles established in our *Benton County* decision regarding RW's PETT obligation, and RW's favorable treatment of the State of Nevada's PETT claim, when taken together, support the State's position and compel the conclusion that the State should receive a PETT grant. (The appropriate amount of the grant will be considered below in Sections IV.B. and IV.C. of this opinion.)

1. The NWPA and the legislative history of the PETT provision, while sparse, tend to favor approval of PETT grants to the affected jurisdictions

The Department of Energy is uniquely responsible under the law for conducting site characterization of potential high level radioactive waste repositories. Section 113(a) of the NWPA, as originally enacted, directed the Secretary to carry out site characterization of the candidate sites approved under section 112. Site characterization of candidate sites is an end in and of itself in the first stage of the repository selection process envisioned in the NWPA. The money to fund site characterization comes from the Nuclear Waste Fund established under section 302 of the NWPA, and it is appropriated by the Congress based on budget requests submitted by the Secretary. Under the aspects of this legislative scheme that are relevant to the present PETT appeal, it is more accurate to analogize DOE's activities at Hanford to a private general contractor performing site characterization for hire than to say that DOE is performing site characterization on its own land with its own people as a prelude to performing a service contract for waste disposal at some time in the future. Later in this Decision, it becomes evident that RW's focus on the standard contract for waste disposal as the basis for an alternative legal fiction supporting its denial of PETT for the B&O tax does not comport with the legal reality established by the NWPA.

The language of section 116(c)(3) is general, and the legislative history of the PETT provision is scanty. The Congress did not consider the fine details of State law, and obviously did not anticipate that the application of the Washington B&O tax would be problematical in the way we find in this case. The only mention of site characterization in the legislative history concerns what we dubbed the Hanford "grandfather clause," which was inserted in the NWPA by former Congressman Sid Morrison, whose District then included the BWIP. *Benton County*, 26 DOE ¶ 80,145 at 80,618. That provision has no special relevance to the main issue in this appeal, whether the State should receive PETT for the B&O tax. (However, it is relevant to another issue, discussed later in this decision, whether the State should receive any PETT for the period before May 28, 1986.)

The only mention of PETT in the legislative history is a statement by former Senator J. Bennett Johnston, ranking minority member of the Senate Energy and Natural Resources Committee and one of the sponsors of the legislation, at the time the NWPA was originally being considered for passage. Senator Johnston stated, in relevant part, "that a State should not be worse off by virtue of having one of these facilities in their State than they would be in terms of taxes, at least." See NOIP, RW's Hearing Exhibit 14 at 6, *citing* 128 Cong. Rec. S4132 (April 28, 1982). Neither of these historical references sheds any light on the specific B&O tax issue. However, the grandfather clause shows the Congress knew that preliminary geological studies of the Hanford site were ongoing when the NWPA was enacted. Sen. Johnston's statement offers insight into the policy underlying the PETT provision, and it weighs in favor of the State's position, since the State would clearly be worse off if it were unable to receive PETT for the B&O tax. In quoting the Senator's remark in the NOIP, RW adopted a policy in favor of granting PETT to eligible jurisdictions.

While the statute's legislative history is sparse, there are a number of documents that may be used in reaching a proper interpretation of section 116(c)(3). Those are the NOIP, the *Benton County* appeal decision, and the PETT grants to Nevada. We will discuss each of these in turn.

2. RW's interpretation of the PETT provision in the NOIP

The NOIP carries out the policy objective of section 116(c)(3) by enumerating several categories of activities that qualify for PETT. For purposes of the present appeal, it is most significant that one of the specific categories mentioned is "activities subject to business or income taxes." We take notice of the fact that business or income taxes are usually based on some measure of a taxpayer's sales or revenues, and the Washington B&O tax is a typical business tax in this respect. While RW knew that Washington was one of the two States that would be eligible to receive PETT when it formulated the NOIP through a notice and comment process, RW, like the Congress, did not deal with any issues that could arise in applying the Washington B&O tax. Nor did Washington State raise any questions about the specific application of its B&O tax during the notice and comment process that preceded issuance of the NOIP, even though we learned during the hearing held on this appeal that Department of Revenue officials had earlier recognized that "this could be a real can of worms, as we've never had to determine B&O tax on nonproprietary governmental activities." RW's Hearing Exhibit 3, at 4. Thus, the NOIP does not address the specific issue before us. However, when we consider the implication of the specific phrase "activities subject to business or

income taxes," and look carefully at the other types of activities that were deemed eligible for PETT, we find below that the NOIP is another piece of evidence that supports the State's position.

Following the principle that affected jurisdictions should receive "compensation coextensive with the amounts the taxing jurisdictions otherwise could collect as taxes if site characterization activities were carried on by private parties," the NOIP determined that the following types of activities would be eligible for PETT:

> (i) activities that impact the assessed value of real property; (ii) activities carried out prior to May 28, 1986, but only to the extent that the residual value of these activities after May 28, 1986 are treated as improvements to real property, used in support of site characterization for purposes of assessment valuation; (iii) ownership or possessory use of personal property; (iv) purchase or transfer of personal property acquired in one State for use in an eligible State; (v) use of motor vehicles; (vi) use of special fuels; (vii) payment of salaries to Federal employees; and (viii) activities subject to business or income taxes.

NOIP at 42318. The preceding list is not exclusive, and the NOIP recognized that other taxable activities undertaken by DOE to evaluate the geologic suitability of a site may also be considered in the calculation of PETT.

Since activities subject to business or income taxes are eligible for PETT, it is reasonable under the NWPA and the NOIP to use the specific amount of funds expended by the DOE for the BWIP site characterization as a surrogate for gross income to determine the PETT grant to Washington State for the B&O tax. As the State points out, RW's argument that there was no gross income generated by the BWIP activities is purely tautological, and at odds with the NOIP's mandate. Section 116(c)(3) requires the DOE to determine the amount of PETT by viewing site characterization activities carried out by a Federal project using Federal money on Federal land as if they had been performed by a private entity subject to taxation. Given the scope of that mandate, DOE should take the small step of using a legal fiction purely for the purposes of measurement. This compensates Washington for the business tax revenues it could have realized had the site characterization activities been carried out by a private firm.

The State's position is reasonable because without some way of making "business taxes" eligible for PETT notwithstanding the lack of any gross income for DOE's characterization of candidate sites, the provision in section 116(c)(3) would be a nullity. Indeed, no activities conducted by the DOE under the NWPA would be expected to earn income, but this is not an insuperable problem since there are ways of coming up with alternative methods of measuring their value for PETT purposes. If we assume the State is right in its interpretation of the legislative intent of the PETT provision in section 116(c)(3), then it is necessary to analogize the BWIP to a private entity subject to taxation and create a surrogate for gross income.

3. *The principles established in the Benton County appeal require an interpretation of section 116(c)(3) that favors PETT grants*

To the extent possible, this case should be decided in a manner that is consistent with the agency's decision on the *Benton County* PETT appeal. In that case, we rejected a similar, extreme position taken by RW which would have resulted in a virtual denial of the County's PETT claim for real and personal property taxes. We held that the statute had to be construed in such a way as to give effect to the principle that Congress intended local jurisdictions to receive PETT grants for site characterization activities that would be subject to taxation if undertaken by private entities.

In *Benton County*, RW did not resist the basic legal fiction required by the statute—viewing the Hanford site characterization as a private activity subject to taxation—as it has done in this case. The principal issue in *Benton County* involved the application of the PETT statute to an ad valorem property tax on the land occupied by the BWIP. RW accepted the idea inherent in the PETT statute of the BWIP's fictional conversion from a Federal project, exempt from taxation under the doctrine of sovereign immunity, to a private entity subject to taxation. Instead, RW's opposition to the Benton County PETT claim mainly took the form of minimizing the assessed value of the BWIP land by viewing the project several years after the improvements had been removed and the site restored to a relatively pristine state. After reviewing the historical context and the legislative history of the PETT provision, we found RW's restrictive treatment of the County's PETT claim was inconsistent with the policy underlying the PETT provision of the NWPA, as interpreted by DOE in the NOIP, which states that:

> the Congress intended to provide a level of compensation for the affected jurisdictions that would be coextensive with the amounts the taxing jurisdictions otherwise could collect as taxes if site characterization activities were carried on by private parties.

26 DOE ¶ 80,145 at 80,627, *citing* NOIP, 56 FR at 42317.

In the present case, RW seems to have retreated one step. In effect, it is taking the position that section 116(c)(3) does not require treating the BWIP as if it were a private entity subject to taxation. RW has done this indirectly, by rejecting the State's argument that it is necessary to use the BWIP budget expenditures as a surrogate for gross income in order to effectuate the legislative objective in section 116(c)(3). RW has taken an equally restrictive approach in its alternative reasons for rejecting the State's PETT claim. RW has formulated a hypothetical situation in which the BWIP is considered a branch of a foreign corporation that would not be required under Washington law to pay B&O tax on its site characterization activities. At the hearing held on this appeal, RW also postulated a series of "alternative fictional tax theories" that analogize DOE's role in the Hanford site characterization to a managing agent or a construction manager rather than a general contractor. In addition, as another argument RW would have us focus entirely on the ultimate goal of future waste disposal. Since disposal has not yet occurred, RW argues that no taxation is appropriate. RW would thereby have us disregard the express statutory mandate in NWPA section 113(a), namely, that the Secretary perform site characterization at "candidate sites," and grant PETT under section 116(c)(3) to affected jurisdictions "were they authorized to tax <u>such site characterization activities</u>" (emphasis added). All of RW's analogies and its reasons for denying the PETT claim ignore the express statutory language of the NWPA and the pervasive nature of the B&O tax, which is designed to reach all business activity in Washington State.

4. The Washington PETT claim should be treated the same as the Nevada PETT claim

To the fullest extent possible, the Washington PETT claim should be treated in a manner consistent with the Nevada PETT claim. Since two States were eligible initially under the NOIP to submit PETT estimates, it is relevant for purposes of Washington's appeal to consider the manner in which DOE handled the PETT process with Nevada. As we noted in *Benton County*, there is nothing in the NWPA statute that would warrant treating Washington differently than Nevada, for the period before the termination of Washington's PETT eligibility mandated in the 1987 NWPA amendments. The PETT claim of Nevada based upon site characterization activities at Yucca Mountain was resolved through a negotiated settlement. OHA has no information about whether RW gave Nevada PETT for any business taxes. However, the fact that the matter was settled makes it seem likely that RW paid at least some business taxes to Nevada. In order to ensure that Washington is being treated the same as Nevada, and thus help resolve the present case, RW will be required to submit a report to OHA within 30 days after it receives this decision, explaining how it treated Yucca Mountain's "activities subject to business or income taxes" for purposes of the Nevada PETT settlement.

5. We conclude that RW applied an erroneous interpretation of the NWPA to the Washington State PETT Claim

To summarize, it is our view that RW has adopted an overly narrow interpretation of section 116(c)(3) that is inconsistent with the statute. Its refusal to accept the State's use of the BWIP budget expenditures as a surrogate for gross income for purpose of the B&O tax ignores the policy underlying the PETT provision, the mandate of the NOIP, and common sense. In a series of alternative theories, RW has postulated a fictional corporate structure that it would impute to the BWIP, combined with a fictional role for the DOE in the Hanford site characterization project, all to reach the conclusion that the State would receive no PETT for the Washington B&O tax. This is an extreme position. Barring the State completely from getting any B&O tax revenue for a site characterization project located within Washington with extensive commercial aspects that constituted "industrial activities," is wrong because it frustrates the purpose of the statute, as interpreted by RW in the NOIP. It is also inconsistent with our Decision in the *Benton County* appeal, which considered many of the same fundamental issues. In *Benton County*, we described the historical context of the PETT provision, and concluded that the Congress intended the statute to be interpreted to favor approval of PETT grants. Finally, it is inconsistent with RW's treatment of Nevada's PETT claim, when there is no basis in the statute or NOIP for treating Washington differently from Nevada. We therefore conclude that the State has met its burden of proving that RW erred in its application of the PETT statute to the facts of the present case. We next consider the proper amount of Washington's PETT grant by reference to the extensive record developed in this appeal on the B&O tax.

B. Determining the proper amount of Washington's PETT grant

The State contends that section 116(c)(3) requires RW to analogize the BWIP to a private general contractor performing site characterization for profit, and to use the BWIP budget expenditures as a surrogate for gross income to determine the amount of B&O tax for PETT purposes. RW has

interposed a number of arguments, all of which would reduce the amount of B&O tax. We begin by describing the nature of the B&O tax itself.

1. The B&O tax is a pervasive tax on business activity in Washington and has been extended to cover for-profit entities with unusual accounting systems, to non-profits, municipal corporations, in-kind petroleum exchanges, and to cost-plus fee government contracts, by using "surrogates for gross income"

According to the NOIP, for a jurisdiction to be eligible to receive a PETT payment for site characterization activities: (i) the jurisdiction must have the requisite taxing authority, and (ii) the jurisdiction must levy taxes applicable to non-Federal activities that are similar to the site characterization activities conducted by the Federal Government. *Id*. at 42318. The State has met these requirements by showing that it has the authority to collect B&O tax:

> There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

Wash. Rev. Code § 82.04.220. The B&O tax is Washington's principal tax on business activities, and it is intended to reach all business activity within Washington State. See State's Hearing Exhibit 8. In keeping with the pervasive nature of the B&O tax, the terms "person," "business," and "gross income" are broadly defined. For example, the word "person" as defined for purposes of the B&O tax includes "the United States or any instrumentality thereof." Wash. Rev. Code § 82.04.030.

RW has not challenged the State's assertion that it has the general authority to collect the B&O tax. Instead, RW has argued that "a private entity with no gross income would pay no B&O tax." This argument is not supported by the evidence. As noted elsewhere in this Decision, the record reflects many instances in which Washington State's Department of Revenue, its Board of Tax Appeals, and its courts have applied the B&O tax to entities that did not have "gross income" within the conventional meaning of that term. These include nonprofit associations (the YMCA), and municipal governments (the cities of Seattle and Tacoma), private entities whose accounting systems recorded not profits but reimbursement for the cost of services (the Pullman Co.), refiners using in-kind petroleum product exchanges (Shell Oil Co.), and cost-plus fee contracts (the managing and operating (M&O) contractors at the Hanford Reservation). Thus, the weight of the evidence is that public and private entities with no gross income do pay B&O tax to the State of Washington. The situation presented in the instant case is unusual, but it is by no means unprecedented.

Not only does it lack factual support under Washington tax practice, but RW's position begs the question because it ignores the legal fiction required by the PETT statute and RW's own interpretation in the NOIP: the assumption that site characterization activities at a "candidate site" were performed by a private entity subject to business and income taxes. We agree with the State that merely assuming that the BWIP was a private entity does not go far enough to give meaning to section 116(c)(3). The only interpretation that achieves the purpose of the statute is to view the

BWIP as a private entity like a general contractor performing site characterization for a fee, which can be measured by the amount of funds spent for the project. As explained below, the testimony of the expert witnesses at the hearing provided additional support for this interpretation of the PETT statute.

2. The expert opinion testimony and documentary evidence submitted at the hearing

A. The State's Witnesses

The hearing held in this case was useful since it provided a live forum for the expert witnesses called by the State and RW to debate their competing theories. All of the witnesses called by both parties had worked for the Washington Department of Revenue (DOR) at one time, all of them had expert knowledge about the B&O tax, and some had been directly involved in the audit that formed the basis for the State's PETT claim. The State's two principal witnesses, Frank Akerly and David Wiest, explained what the DOR actually did when faced with the task of submitting a PETT claim for the B&O tax. We found the DOR's application of the B&O tax to the Hanford site characterization activities to be reasonable and consistent with the NWPA. RW's two principal witnesses, Jerry Hammond and Les Jaster, were offered to second-guess the theory underlying the DOR's PETT claim, and to support RW's alternative theories that would either reduce the amount of PETT for the B&O tax for the Hanford site characterization, or eliminate the PETT obligation for that tax altogether. Ultimately, we found the factual and legal assumptions made by RW's witnesses to be unsupported by the record, and as a result, the positions they advocated were unconvincing.

The State's first witness, Frank Akerly, was the Washington Department of Revenue (DOR) auditor who examined the DOE's BWIP records and prepared the Audit Report that was used in formulating the State's PETT claim. Akerly described the essential features of the B&O tax as "a tax that's on every individual and business that has any business or industrial activity in the State of Washington, whatsoever. It's based on gross income without any deduction, and it pyramids." March 28-29, 2001 Hearing Transcript (hereinafter cited as "*Tr.*") at 39. He explained that under the pyramiding aspect of the B&O tax, if a general contractor hires a subcontractor who in turn hires a subcontractor, each one pays tax on the amount that it receives.

Akerly testified that there was a precedent for using DOE's costs as the basis for computing the B&O tax for the PETT claim, since the same approach–using cost information to come up with a B&O tax due–was used for taxing the M&O contractors at the Hanford Reservation. He explained that the Hanford prime contractors had no income other than fee, but "we tax the whole, their expenditures and the fee as a total to determine the tax." *Id*. at 43. (Akerly's account of how the B&O tax is applied to cost-plus fee contracts was later confirmed in the testimony of RW's witness Les Jaster.) Based on information provided by DOE, Akerly testified that at the time of termination, there were approximately 60 DOE employees, and over 800 contractor and subcontractor people working full time on the BWIP site characterization. *Id*. at 46-47; *see also* State's Hearing Exhibits 9 and 10. In addition, Akerly explained that the DOR examined the possible rates, and concluded that the "Service and Other Activities" classification was the most appropriate rate for the B&O tax on BWIP site characterization activities. Under Washington tax practice, according to Akerly, the DOR looks

at the primary purpose of the contract when different types of activities are being performed under one contract, and based on that principle, it applied the Service and Other Activities rate. *Id*. at 47-49.

In its opening statement at the hearing, RW asserted that its consideration of the State's PETT claim for B&O tax began with a search for "an example of what [RW] felt was a comparable activity in the state." *Id.* at 21. According to RW, this was the Echo Bay Mining Company in Denver, which spent $45 million to characterize a site in Washington State, Kettle Falls, to determine if it was suitable for development as a new gold mine. On cross-examination, RW asked Akerly if the firm transferred that amount of money from its headquarters in Denver to its field office in Washington State without paying B&O tax, and Akerly stated that the firm could make the transfer without paying B&O tax "because they're the same entity." *Id*. at 57. Using RW's assumptions, Akerly conceded that since the DOE is part of the Federal government, if he had just applied state law to the BWIP, without considering section 116(c)(3), the situation would be the same as with the mining company. However, in response to a question from the OHA panel, Akerly stated that if someone else paid $45 million to the mining company to do site characterization on the Washington site, in exchange for buying any gold produced at a good price, the mining company would have to pay B&O tax on that $45 million amount. *Id*. at 59. It is the latter situation that most closely resembles the situation of the BWIP, where the Congress mandated in the NWPA that the DOE perform site characterization at candidate sites, and appropriated the money from the Nuclear Waste Fund to pay for it.

In response to a follow-up question from RW, Akerly emphasized that the DOR treated the BWIP site characterization as industrial activity subject to taxation under the B&O tax because the State believed that was required by section 116(c)(3). Aklery maintained that "there would be no allowability of payment[s] equal to taxes if [the BWIP] were considered a nontaxable entity," and he questioned why Congress would have even bothered including section 116(c)(3) in the NWPA if they did not expect the State to receive a PETT grant for the Hanford site characterization. *Id*. at 62. This colloquy with Akerly illustrates the stark difference between RW's scorched-earth approach to the B&O tax PETT claim, and the State's attempt to read meaning into section 116(c)(3). We agree with the State that unless the BWIP is viewed as a taxable private entity that performed site characterization at Hanford for hire, the statutory language would be rendered utterly meaningless.

Moreover, Akerly's testimony illustrates a fundamental flaw in RW's legal fiction. The gold mine example on which RW relies is not analogous to the BWIP situation under section 116(c)(3). In the case of the Denver-based mining company, the site characterization expenditure in Washington State is a pre-development cost undertaken with the firm's own money to decide whether to invest in a new mine. In the case of the BWIP, the site characterization expenditure is required by a Federal statute that also requires the DOE to grant the State PETT as if those activities were performed by a private entity subject to taxation. Moreover, the BWIP site characterization is not a speculative, pre-development cost as in the case of the potential gold mine, but an end it itself–i.e. a task that the Congress expressly directed DOE to perform in section 113(a) of the NWPA. In relying on this analogy, RW appears to have carried over an argument it raised in the *Benton County* case–that certain "soft costs" including pre-development site characterization expenditures–should not be

included in the assessed value of a property until the activity projected for that property, whether operation of a gold mine or a nuclear waste repository, actually begins. We rejected that argument in *Benton County*, and we reject it here since section 116(c)(3) specifically authorizes PETT grants for site characterization by the DOE under section 113(a), regardless of whether a repository is ever built on that candidate site.

The State's next witness, David J. Wiest, was the DOR Field Audit Manager who approved the report prepared by Akerly that formed the basis for the B&O tax claim. Wiest confirmed the choice of the "Service and Other Activities" classification as most appropriate for the BWIP, since it was customarily used for site characterization. He explained that the legislature enacted the "Nonprofit Research and Development" B&O tax rate to be applied to a specific company, and that it could not work for the Hanford site characterization. *Id*. at 69-70; 75-76. He further explained how the pyramiding feature of the tax worked, so that each subcontractor in a chain of contractors would pay B&O tax on the amount they receive from the general or prime contractor, with the prime contractor at the base of the pyramid paying B&O tax on the entire amount it receives from the customer to do the project. Wiest maintained that the B&O tax situation would be the same even if the customer directed its bank to pay one of the subcontractors directly. According to Wiest, each subcontractor would pay B&O tax on the amount it receives and the prime contractor could not escape taxation on a portion of the entire amount just because the payment was made directly to a subcontractor. *Id*. at 77-81. He also confirmed Akerly's testimony that the DOR was required to look at the "overriding nature" of contracts and apply the one B&O tax rate that is appropriate, rather than "bifurcate contracts" and apply multiple tax rates to the different activities. *Id*. at 86-87. The State's attorneys indicated they would submit some cases to support their position on the bifurcation or apportionment of B&O taxes.

On cross-examination by RW, Wiest indicated that the State never considered that DOE was a "managing agent" for purposes of applying the B&O tax to the Hanford site characterization, as RW had proposed in an "alternative fictional tax theory" mentioned in its opening statement. RW Hearing Exhibit 2-E. According to Wiest, the State did not treat the BWIP as a managing agent, because a managing agent would usually have no employees on a project. Wiest added that the State "did not look at DOE as a contractor as such," but "just saw that there was a provision in 116(c) to, for a payment equal to taxes if we looked at a private industrial contractor doing the type of work that was done out there." *Id*. at 97-98. When pushed by RW to explain his thought process, Wiest, like Akerly, questioned why section 116(c)(3) would even have been written if the DOE was not liable for a PETT grant for the B&O tax. *Id*. at 98-99. In response to another series of questions from RW, Wiest maintained that while the State would not impose a B&O tax on a private landowner doing site characterization on its own land with its own employees, section 116(c)(3) mandated a different result in the case of the BWIP, even though the Federal government owned the land on the Hanford Reservation. *Id*. at 108-110.

Wiest's cross-examination ended with a colloquy concerning a hypothetical question asked during Wiest's deposition by RW, known as "Hypothetical L," reproduced below:

> [Question by RW] One, assuming that it is the year 1980. Two, X Corporation is a corporation whose head office is located in New York state. Three, X Corporation employees operate a corporate branch office in Waco, Texas, another branch office in Reno, Nevada, and another branch office in Yakima, Washington. All three branch offices are investigating whether it might be possible to construct a landfill at their sites but, no decisions to construct have actually been made. Four, Y Corporation located in Ohio expects to generate 5 tons of trash per year for the next 20 years for a total of 100 tons. Y plans to accumulate the trash in storage until 100 tons have been accumulated in the year 2000. Five, in the year 1980, the X Corporation head office in New York contracts with Y to take the trash[, and] the contract expressly states no services shall be provided under the contract prior to the year 2000. And the question is the same, what are the Washington state B&O tax consequences to X as a result of the hypothetical L scenario?
>
> [Answer by the Witness] I think it would be real similar to the last example, where if no services, disposal services, actual disposal is provided, it doesn't look like you would have a B&O tax consequence.

November 16, 2000 Deposition of David J. Wiest, at 20-24.

RW has steadfastly maintained that the situation depicted in Hypothetical L is identical to the reality presented in this case, and that it proves that no B&O tax is owed on the BWIP. However, the State's attorneys, Wiest himself, and the OHA panel members, all pointed out the fatal flaw in Hypothetical L, that it fails to mention the existence of section 116(c)(3) so it is different from the real-world situation that we have in this case. *Tr*. at 113-126. Moreover, section 116(c)(3) does not use the term "investigate," as in the hypothetical; it speaks of "site characterization," a task specifically given to the DOE in section 113 of the NWPA. As noted above, site characterization is an end in and of itself that gives rise to PETT grants under section 116(c)(3), regardless of whether a repository is ever operated at a site and regardless of whether or when DOE takes title to, or disposes of, any waste. Contrary to its intended purpose, Hypothetical L proves only that RW has mischaracterized the facts in its legal fiction, and taken a position inconsistent with the law.

RW later recalled Wiest for additional cross-examination about the other hypothetical questions posed during his deposition on November 16, 2000. Specifically, RW asked Wiest if there was "a distinction in the tax treatment of a contract for waste disposal versus a contract for site characterization for hire." *Id*. at 164. Wiest explained that the "service and other activities" rate would apply to site characterization, and there was a different B&O tax rate specifically for waste disposal. In addition, Wiest testified that during the PETT audit, the State never looked at the "Standard Contract" which the nuclear utilities signed with the DOE that provided for waste disposal by the Department. *Id*.; see RW's Hearing Exhibit 10, 10 CFR Part 961. Wiest agreed with RW that there would be no B&O tax due on a contract for waste disposal made in New York unless the person receiving the waste put it in Washington State. In addition, Wiest agreed with RW that if someone in New Jersey contracted with another company to find a place in Washington and study that site in the hope of later sending waste there, there would be B&O tax due on the site characterization for hire. *Id*. at 169. Finally, RW asked Wiest if the State would have taken a

different approach, instead of using the BWIP budget expenditures as the basis for its B&O tax PETT claim, had they found out that the money the DOE used for the BWIP site characterization was coming from utility companies who were paying for waste disposal services. Wiest said that the State had never considered that point. *Id*. at 171.

RW's second round of questions for Wiest illustrates a consistent flaw in RW's theory of the case, namely, its notion that site characterization of the BWIP under section 116(c)(3) is not an end in and of itself that gives rise to an obligation to make PETT grants to Washington State. The implication of RW's allusion to the waste disposal contracts between utilities and DOE is that the money in the Nuclear Waste Fund cannot be used for PETT payments because it was intended for "waste disposal." That position shows how RW would skirt the NWPA scheme by reading out the PETT provision in section 116(c)(3). RW's apparent conviction that Washington should not get a PETT grant for B&O tax on the BWIP because the repository will not be built at Hanford may explain why RW has strained to come up with any reason it can to avoid making the payment. Site characterization of "candidate sites," i.e. potential repository locations approved by the President, was always an integral step in the waste disposal process envisioned by the NWPA. More importantly, under section 116(c)(3), site characterization is all that is needed to support a PETT grant to Washington for the B&O tax, as long as the State can satisfy the general PETT eligibility requirements stated in the NOIP.

The State's third witness was Donn Smallwood, a former DOR employee who testified on Washington tax policy. Smallwood provided corroboration for the State's description of the B&O tax, which in 2000 generated approximately 17 percent of the State's revenue According to Smallwood, this figure was "fairly consistent" over the time period concerned. *Id*. at. 129-132; see State's Hearing Exhibit 8 (B&O tax represented 13 percent of all taxes collected by the State in fiscal year 1985). Smallwood confirmed that the B&O tax applies not only to entities that are in business to make a profit, but to all who generate gross receipts, "whether you're organized for profit, do in fact make a profit, or, or organized as not for profit." *Id*. at 133. He also confirmed that the "Service and Other Activities" category was a catch-all category for business activities that are not covered by one of the several tax rate categories specified by the legislature. Smallwood also confirmed what previous State witnesses said about the pyramiding feature of the B&O tax. *Id*. at 134-135.

On cross-examination, Smallwood's testimony was not particularly helpful to the parties, except in regard to the application of the B&O tax to grant payments. He declined to answer many of RW's questions, and he denied having sufficient knowledge of the Federal legislation involved. *Id*. at 144. Finally, RW asked Smallwood if "some of the items in the BWIP budget included money going to Indian Tribes in the form of grants, and these grants would apparently be for helping the Tribes to understand what the BWIP project was about," how those grants would be treated for purpose of the B&O tax. Smallwood replied that there is an exemption which applies to the receipt of grants, and that if an entity passed through a grant, "the only question is whether there would be taxes owed by the ultimate recipient." *Id*. at 156-57.

B. RW's Witnesses

RW presented four witnesses to support its contention that the State should have viewed the Hanford site characterization activities differently for purposes of applying the B&O tax. The first two witnesses called by RW were Kenneth J. Capek, a manager in the Audit Division of the Washington State Department of Revenue, and Don Taylor, Research Analysis Manager for the Washington DOR. Unlike Akerly and Wiest, neither Capek nor Taylor worked on the actual BWIP audit that formed the basis for State's PETT claim, and their testimony was not particularly helpful to RW's case.

RW attempted through Capek to buttress its alternative theories of looking at the Hanford site characterization for purposes of the B&O tax, which were expounded during RW's opening statement and depicted in a series of charts designated RW Hearing Exhibit 2. RW asked Capek to explain how a DOR auditor would try to figure out if the DOE's role in the Hanford site characterization project was more like a contractor or a managing agent. Capek testified that the auditors would look at the contract, the underlying Statute that was being applied, and what activities actually occurred. *Tr*. at 178. Capek confirmed that it was more important who controlled the work performed by subcontractors rather than who wrote the checks for that work. *Id*. at 180. According to Capek, if there was a contract directly between a subcontractor and the Congress, then the DOE would not have the tax liability for that contract. *Id*. However, since the record shows DOE was responsible for the Hanford site characterization under the NWPA, and DOE functioned like a general contractor that hired the subcontractors who worked on the project, we find that Capek's testimony on those points did not support RW's theory of the case, as outlined in Hypothetical L. To the contrary, it further demonstrated that the State's legal fiction is significantly closer to reality than RW's legal fiction. *See* State's Hearing Exhibits 9 and 10.

RW also tried to show by Capek's testimony that the role DOE played in the Hanford site characterization process was less like a general contractor, and more like a "managing agent" or a "construction manager." *Id*. at 183-188. Neither a managing agent nor a construction manager would be liable for B&O tax on the entire amount of the BWIP expenditures. Underlying these theories was RW's notion that DOE merely passed through the payments to its contractors on the Hanford site characterization project so those contractors were liable directly to Congress which appropriated the money from the U.S. Treasury. However, since DOE was responsible for the project under the NWPA, and actually engaged the contractors who performed portions of the work, there is no factual basis for treating the Department as a managing agent or a construction manager.

RW's second witness, Don Taylor, worked with the State officials who first considered how to implement the PETT provision in section 116(c)(3) of the NWPA. In 1986, he wrote a memo to Donn Smallwood and another DOR official that is in the record as RW's Hearing Exhibit 3; this memo characterized the task as "a real can of worms, as we've never had to determine B&O tax on nonproprietary governmental activities." *Tr*. at 197. RW asked Taylor why, in 1988, he thought the Hanford site characterization project should be taxed as if it were being conducted by a private

entity. *Id.* at 205. Taylor explained that "as a researcher trying to make some sense out of this federal statute that didn't make a lot of sense, what that told me is that we were. . . directed to constru[e] the activities that happened with regard to site characterization as if it were conducted by a private entity." *Id*. Finally, Taylor confirmed that he was not involved in the audit of the BWIP or the preparation of the actual PETT claim that is the subject of the present appeal. *Id*. at 211.

RW's two principal witnesses were Jerry H. Hammond and Lesley J. Jaster, both former DOR audit officials who are now Certified Public Accountants in private practice. RW submitted separate expert witness reports from Hammond and Jaster before the hearing. Both of these reports attempted to advance RW's various theories, but they also revealed the inherent weakness in RW's position. Hammond's report opined that the State "has not identified any transaction or activity DOE engaged in that would be subject to [B&O] tax." Hammond Report (January 18, 2001) at 1. Regarding the PETT provision in section 116(c)(3) of the NWPA, Hammond's report stated that "An auditor looking at the enabling statute still has to determine if the activity takes place in more than one state, is the structure that of a branch or separate corporation, is there nexus, and finally, what activity is engaged in." *Id*. at 6. Hammond's report went on to explain the basis for his opinion that a proper analysis of State tax law and the factual situation should have concluded that there was no transaction on which to base the B&O tax because the Hanford site characterization was comparable to a site characterization undertaken before operating a new landfill on company-owned land by a Washington State branch office of a foreign corporation, funded by an intra-company transfer. Hammond's report wholly supported RW's theory of the case, as embodied in "Hypothetical L." According to Hammond, there would be no B&O tax due until the taxable activity of waste disposal in the landfill takes place and the landfill generates income. *Id*. at 8.

Jaster's report was similarly aligned with RW's fundamental position that no B&O tax should be due for the BWIP site characterization because it was done with Federal money on Federal land, and therefore analogous to a business entity who performs site development activities using its own employees or purchases these services from contractors. Jaster Report (January 15, 2001) at 2. According to Jaster, "the B&O tax applies to persons who perform services for others," and he took the position that the BWIP site characterization was not a service performed for others. *Id*. Jaster opined that the DOR will not generally bifurcate a contract into the various possible activities being performed as part of a contract, but will impose the B&O tax on the predominant activity. *Id*. Jaster also asserted that if services were performed "both within and without Washington, the taxpayer is entitled to apportion the income received." Finally, Jaster's report challenged the State's use of the entire amount appropriated for the Hanford site characterization as a surrogate for gross income, and opined that only money received for waste disposal "apportioned to the collection activity that will occur in Washington would require a 'payment equal to taxes.'" *Id*. at 3.

These two reports share several fundamental shortcomings, which permeate RW's determination to deny PETT for the B&O tax. They ignored the fact that site characterization is a statutory duty in and of itself that gives rise to the obligation to pay PETT grants under the statutory scheme in the NWPA, as interpreted by RW in the NOIP. In addition, they shared the same flaw as RW in its refusal to use the type of legal fiction required by the statute and NOIP. They would have us treat the entire Federal government as a monolith, and refuse to analogize the BWIP site characterization

activities as work done for others by a private general contractor subject to the B&O tax. Finally, both reports focused incorrectly on the ultimate goal of waste disposal as the only activity that could make the BWIP subject to the B&O tax. Even though the bulk of Hammond and Jaster's testimony at the hearing was so doctrinaire that it missed the point, both witnesses also addressed issues regarding the application of the B&O tax to the BWIP that we find relevant to our analysis later in this decision.

At the hearing, Hammond testified that his last position in the DOR was manager of Audit Standards and Procedures, where he was responsible for reviewing any audit assessment over $100,000 and any disputed assessment. *Tr*. at 232. Hammond was not involved in the submission of the PETT claim. *Id*. at 255-256. He criticized Akerly's audit as "a very quick and superficial analysis of the situation." *Id*. at 234. Hammond alluded to his experience auditing the contract manager who oversaw the construction of the Washington Public Power Supply (WPPS) nuclear power plants, and recounted how the WPPS audit found that the taxpayer should have applied different B&O tax rates to different categories of business activities such as service, retailing, and public road construction. *Id*. at 235-238. When asked to explain when it was appropriate to apply different tax rates to different parts of the same project, Hammond said that depended on the contracts involved, and that Akerly's audit showed different activities performed by different subcontractors that could have been taxed at different rates. *Id*. at 241-241. Hammond also questioned the legitimacy of some of the BWIP expenses appearing on RW Hearing Exhibit 6, an itemized list prepared by RW consultant Carl B. Ellis, including grant payments to Indian Tribes. He thought those payments should not have been legitimately included among the costs of site characterization, even if they were mandated by section 116 of the NWPA. *Id*. at 244-245, 266; RW Hearing Exhibit 6. Similarly, Hammond believed that payments to BWIP subcontractors located outside of Washington State, e.g., in Illinois and Nevada, should not have been considered site characterization costs for purposes of the B&O tax. RW Hearing Exhibit 6; *Tr*. at 247. Hammond admitted that he had not examined the information furnished by DOE/RL to Akerly, but he asserted that if he had been the audit manager reviewing Akerly's work, he would have "to question how those costs are associated with site development." *Tr*. at 250-254.

Hammond next introduced two Washington Tax Decisions to support RW's claim that corporations doing some of their business in Washington State could exclude gross income derived from outside the State from the gross income figure used to calculate B&O tax liability. RW Hearing Exhibits 7, 8. Based on the names of some subcontractors listed on RW's Hearing Exhibit 6, Hammond ventured that research and development work performed outside of Washington State should not have been counted towards any B&O tax liability for Hanford site characterization activities. However, Hammond admitted that he did not know whether those subcontractors, including "Argonne Laboratories," "Chicago University," Batelle, and Oregon State University, actually did their research work inside or outside of Washington State. Nor did Hammond indicate whether any work performed by out-of-state subcontractors was so closely connected to the Hanford site characterization that it would be subject to the B&O tax under the principle established in *Chicago Bridge & Iron Co. v. State Dept. of Revenue* (1983) 98 Wash.2d 814, 659 P.2d 463, *appeal dismissed* 104 S.Ct. 542, 464 U.S. 1013, 78 L.Ed.2d 718, discussed later in this decision. *Tr*. at 259.

After reading section 116(c)(3), Hammond concluded that it would be proper to tax a portion of any money DOE receives under the "Standard Contract for Disposal of Spent Nuclear Fuel" (10 CFR Part 961, RW Hearing Exhibit 10) from the only commercial nuclear power plant operating in Washington, WPPS Number 2, if and when a high level nuclear waste repository begins operating in Washington. *Id*. at 283-294. Hammond maintained that "the PETT claim should be based on that income stream, rather the cost of production." *Id*. We find this suggestion disingenuous, since we know the repository will not be built in Washington. Moreover, by focusing on waste disposal, Hammond, Jaster, and their RW interlocutors simply ignored the mandate of section 113 of the NWPA that the DOE conduct site characterization at "candidate sites," which creates an obligation to make PETT grants to eligible jurisdictions.

Based on his discussions with RW's attorneys, and his observation of the other witness who testified before him, Hammond also voiced his agreement with the RW theory that DOE's role in the Hanford site characterization was more like a construction manager than a prime contractor. Hammond noted that a construction manager would have no B&O tax liability for any contracts that are signed directly between the owner and the contracting party where he merely acts as managing agent. *Id*. at 299. This would mean that only certain portions of the money Congress appropriated to DOE for the Hanford site characterization would be taxable at the construction manager level. However, when questioned by the hearing panel, Hammond admitted he had no actual knowledge of DOE's role in the Hanford site characterization. *Id*. at 301-305. As a result, Hammond's musings about whether DOE more closely resembled a construction manager than a prime contractor were not convincing.

On cross-examination, Hammond was unable to identify the source of the footnote on RW Hearing Exhibit 6, the list prepared by RW consultant Carl Ellis, which speculated that "non RL contractors," i.e. those not located in Richland, "expended their funds outside the State." Consequently, that footnote in RW Hearing Exhibit 6 was stricken from the record. *Tr*. at 308. Hammond also conceded, in his answer to a hypothetical question from the State's counsel, that a Washington company doing site characterization at Hanford for $20 million would owe B&O tax on that entire amount, even if some portion of the money was used to hire a subcontractor based in Ohio to conduct the soil analysis. *Id*. at 320. Hammond agreed with a statement in Jaster's expert witness report, echoed earlier in the hearing by the State's witnesses, that "[t]he DOR will generally not bifurcate a contract into the various possible activities being performed as part of the contract, but will impose the B&O tax on the predominant activity." *Id*.

Jaster, RW's final witness, is a CPA who worked for many years as an auditor and audit manager in the DOR before joining a private accounting firm. During the latter part of his government career, Jaster was involved in analyzing the impact of federal statutes and how they affect Washington State law. Currently, Jaster represents private clients in matters involving Washington tax law. *Id*. at 332-336. RW attempted to use this knowledgeable witness to support its several theories why Washington State should not receive a PETT grant for the B&O tax.

Jaster testified that in his opinion, the State cannot receive PETT for the B&O tax unless there is an operating repository at the Hanford site. According to Jaster, the standard contract in 10 CFR Part

961 calls for payments by utilities to DOE for waste disposal. This means that the waste disposal, whenever it occurs in the future, could be taxed, but not until that time. *Id*. at 336-337. Jaster maintained that under various hypothetical scenarios posed by RW's attorneys, if contractual payments were made for waste disposal, no B&O tax would be due while possible landfill sites were characterized, *id*. at 343, and if no waste is ever disposed of in Washington, no B&O tax would ever be due. *Id*. at 349. However, Jaster conceded that if there were a site characterization for hire contract and someone outside the State pays for site characterization in Washington, then B&O tax would be due. *Id*.

Commenting on RW's "alternative fictional tax theory," Jaster retreated to the original RW position that no B&O tax is due at all, because he does not believe "DOE itself has a contract to build or do site characterization activities for [the] Congress and President." *Id*. at 356; RW Hearing Exhibit 2. He went on to explain that he thought DOE was more like a contract manager, even though the Department had "lots of people" working on the Hanford site characterization, because "the . . . payments are coming from the U.S. Treasury." *Tr*. at 357. Jaster ventured that "[i]f you looked at, at the Contract, I would expect that the contractors are the ones that have contracted with the Federal Government to perform the work, and so they are the ones that have the liability to perform that, that work." *Id*. The application of RW's alternative fictional tax theory "would exclude the pyramiding except to the extent that DOE itself does some activity and, and receives some appropriations from the Federal Government." *Id*. However, Jaster conceded that "if it's my liability to perform the contract, then I simply subcontract a hundred percent of the services out . . . I'm still subject to the B&O tax, regardless of who pays." *Id*. at 358.

From this preceding colloquy with Jaster, we can reasonably conclude that if DOE were "liable" for the performing the Hanford site characterization, even if it hired subcontractors to do all the work, it would still be subject to the B&O tax. The remainder of Jaster's related testimony was unconvincing. Since the NWPA and the facts documented in State's Hearing Exhibits 9 and 10 make it clear that DOE was responsible for the site characterization, and DOE hired the contractors for the BWIP, there is no factual support in the record for Jaster's opinion that DOE's role in the process was more like a construction manager than a general contractor.

Jaster next addressed the validity of the State's use of a proxy for gross income under his interpretation of Washington law. He opined that there was no provision in the statutes for measuring gross proceeds of sales or gross income of the business by cost. The main exception Jaster noted was a cost-plus contract "when the contractor has agreed to be compensated by recovery of all of their costs plus generally some fee," in which case the DOR uses costs plus the fee as the gross proceeds of sales. *Id*. at 363. In general, Jaster agreed with RW's counsel that the State of Washington does not have the authority to tax when there is no gross revenue. *Id.* But this is a meaningless point, in view of Akerly's prior testimony that under Washington tax practice, the State taxed the M&O contractors at Hanford on the basis of their costs plus fees, and the other evidence of cases showing the DOR's creative application of the B&O tax to entities and transactions that did not show gross revenue. Since it is without foundation, we reject this argument.

Giving his analysis of section 116(c)(3), as interpreted by RW in the PETT Notice, Jaster indicated that "if some B&O tax applied, or any tax applied, the Federal Government here should be paying a tax . . . equal to the tax that any other organization would pay." *Id*. at 369. And "if the State is authorized to tax the federal/state site activities at such site, then the jurisdictions were eligible for payments equivalent to those amounts." Id. at 370. Jaster pointed out that section 116(c)(3) was "not written specifically for the State of Washington. This includes taxes that would be imposed on, in several states. To the extent that a repository was being considered in Nevada, Texas as well as Washington, this section would apply to them." *Id*. He went on to challenge the assertion by the State's witnesses that the PETT provision would be rendered meaningless if RW does not pay a B&O tax, stating that "it's meaningful to the extent that if . . . some . . . tax applies, then the tax is going to be due." *Id*. at 371. Jaster noted that RW has already agreed that Washington retail sales tax is due, and that the statute had some meaning with respect to real property tax, the basis for the PETT granted to Benton County. He said that "[t]he only reason it may not have any meaning with respect to the B&O tax is because if the B&O tax doesn't apply to any other taxpayer that's situated here, then it's . . . not going to have any more meaning to the Federal Government either . . . ." *Id*.

Jaster argued creatively, but he ultimately fell back on a key RW assumption to support his opinion that no B&O tax would be due on the Hanford site characterization activities. Referring to the statement in the PETT Notice that "PETT is . . . contingent upon the taxing jurisdiction having the requisite taxing authority," NOIP, 56 Fed. Reg. at 42318, Jaster maintained that the State "would require DOE to pay an amount that is not equivalent to the tax that a taxpayer standing in the same shoes who is not in the Federal Government would have to pay." He based this opinion on RW's characterization that "the DOE is not being paid to perform site characterization for hire. There is no other taxpayer that we can identify who develops land, does site characterization, any of those type of activities, does it for themselves, not for hire, would have to pay that tax . . . ." *Tr*. at 374. As noted above, this opinion is based on RW's faulty assumptions of fact and its misinterpretation of the law.

Finally, Jaster discussed two decisions by the Washington State Supreme Court. The first case held that if there is any ambiguity in a taxing statute, the ambiguity needs to be resolved in favor of the taxpayer, which Jaster thought supported RW's position. *Buffelen Lbr. & Mfg. Co. v. State*, 32 Wn. 2d (1948), RW Hearing Exhibit 15. However, the OHA panel noted that the *Buffelen* case just as easily could be read to support the State's interpretation of Washington law that its authority to tax the Hanford site characterization activities was not ambiguous. *Tr*. at 376-378. The second decision held that road building, when performed by a logging company while harvesting timber on land owned by the State, was incidental to the main contract for the purchase and sale of timber, and was not an activity subject to the retail sales tax. *Lyle Wood Products, Inc. v. Dept. of Revenue*, 91 Wn. 2d 193, 588 P.2d 215 (1978), RW Hearing Exhibit 16. Jaster interpreted the *Lyle* case to support RW's idea of looking at the primary activity of a contract, which he thought was waste disposal, and applying the tax to that activity alone. *Tr*. at 380. According to Jaster, the Hanford site characterization should not be taxable because it is incidental and preliminary to performing the main contract for waste disposal. *Id*. at 381-382.

On cross-examination, the State's counsel asked Jaster if he meant there were ambiguities in the Washington statutes that led him to discuss the *Buffelen* and *Lyle* cases. Jaster replied that the ambiguity is in the federal statutes. *Id*. at 392. This undercuts his assertion that the *Buffelen* case, which dealt with ambiguities in Washington law, supports RW's position.

The State concluded its cross-examination of Jaster by reminding the witness that the subcontractors working on the Hanford site characterization had contracts nominally with the DOE, not with "the Federal government," and that it was DOE that had the responsibility under the NWPA of performing site characterization as a first step in developing a repository. *Id*. at 396-397. This final interchange between Jaster and the State's counsel illustrates how RW and its witnesses attempted to recast reality, and lumped the entire Federal government together in a fictional monolith that ignores the legal and functional separation of powers into different branches of government that operate independently of each other as they have in this case.

3. We conclude that the State's PETT claim for the B&O tax should have been granted

Based on the foregoing analysis of the evidence adduced at the hearing, we find the State has met its burden of proving that it had the requisite taxing authority under Washington law and tax practice to apply the B&O tax to the Hanford BWIP site characterization, and that it was reasonable and proper on the basis of the entire legal and factual record, to use the cost of the BWIP budget expenditures as the basis for calculation of that tax. Thus, we find that RW should have granted the State's PETT claim. Having decided the issue of PETT eligibility for the B&O tax in favor of the State, we next consider a number of ancillary issues, including (1) whether the entire amount expended for the Hanford BWIP site characterization should have been taxed under the "services" rate, (2) whether different activities undertaken by subcontractors as parts of the overall project should have been taxed at different B&O tax rates, (3) whether any part of the BWIP expenditure attributable to activities undertaken by subcontractors should be apportioned between Washington and other States, and (4) whether the period of PETT eligibility should run from May 28, 1986 to December 22, 1987, as provided in the NOIP, or run from January 7, 1983 through December 22, 1987, as claimed by the State.

C. Application of the B&O Tax to the BWIP expenditures

1. Pyramiding of the B&O Tax

In its March 23, 1999 Determination and subsequent written submissions during the course of the present appeal, RW's principal position could be described as preemptive, arguing that no B&O tax was appropriate for the Hanford BWIP site characterization. RW did not challenge the fact that the B&O tax is pyramided. However, RW did propose alternative legal fictions regarding DOE's role in the Hanford site characterization, namely that the Department should be analogized to a managing agent, or a construction manager, rather than a general or prime contractor. For clarity, we will address that proposal here. The application of RW's alternative legal fictions would reduce the base of the pyramid, and mean that part of the BWIP expenditure would not be subject to the B&O tax. By contrast, accepting the State's analogy of DOE as general contractor would mean that the entire

amount expended for the Hanford site characterization would be subject to the B&O tax, unless otherwise exempted by apportioning certain expenditures that lacked a sufficient nexus to Washington, an issue considered later in this section. For the reasons stated above, we reject RW's alternative legal fictions, and find that under the law and facts of this case, DOE's role was analogous to a general contractor performing site characterization for hire. The NWPA spells out the terms of the mandatory contract: the Secretary of Energy performs site characterization of "candidate sites," and the Congress pays the DOE for that task. The DOE uses a large number of its own employees, and it hires subcontractors whom it pays. The DOE is ultimately responsible for the task specified in the contract. Therefore, the entire amount of the BWIP expenditures should generally be subject to the B&O tax as the base of the pyramid.

2. Bifurcation of BWIP activities among different tax rates

The State asserts that the "service or other activities" rate is the proper B&O tax rate for the entire site characterization project. During the hearing, several witnesses, including those presented by the State, commented on the so-called bifurcation issue: whether, under Washington law, a single tax rate should be applied to the overall project, or different rates should be applied to different activities. The leading case is *Chicago Bridge & Iron Co. v. State Dept. of Revenue* (1983) 98 Wash.2d 814, 659 P.2d 463, *appeal dismissed* 104 S.Ct. 542, 464 U.S. 1013, 78 L.Ed.2d 718. *Chicago Bridge* involved a constitutional challenge to the imposition of the B&O tax to revenues received by a foreign corporation for work done outside Washington (design and manufacturing) for a project ultimately installed within the State. The Supreme Court of Washington upheld the application of the B&O tax to a foreign corporation's gross income when some of the functions related to that firm's contracts with in-state customers were performed outside Washington. The controlling factor in *Chicago Bridge* was the contract, which was for a lump sum for a project installed in Washington, but designed and built outside the state. Other cases decided by DOR begin by applying the general principle enunciated in *Chicago Bridge*, and the result depends on the nature of the contract involved. For example, the DOR applied different B&O tax rates in a case involving a fixed price contract to perform a variety of activities, each of which is taxable according to its corresponding B&O tax category, where the values assigned to the various activities were negotiated by the parties prior to performance of the contract. 11 Washington Tax Decisions (WTD) 313 (1992). Under these decisions, a condition for bifurcation is that the taxpayer's contract is not a "lump sum" contract, but rather details the dollar values of the various activities. *Id.*; *see also* 17 WTD 247 (1998).

Applying the foregoing legal principles to the present PETT appeal, we must analyze the Hanford site characterization to see what it resembles most: a fixed price contract, or a contract in which different activities have specific dollar values that were separately negotiated. What we see does not make a perfect analogy to a specific category of Washington tax cases. There was no bifurcation of contractual activities among two or more B&O tax rates, since there was not a negotiation between the parties; nor was there a meeting of the minds as in a garden variety government procurement contract. The Hanford site characterization most resembles a mandatory contract that occurred when the Congress enacted section 113(a) of NWPA, ordering the Secretary to do it. No further details or dollar values of the site characterization activities are specified in the statute, so at first blush, the

statutory directive to the Secretary resembles a lump sum contract that would be subject to a single B&O tax rate.

However, the matter is more complicated than it seems, since section 302(e)(2) of the NWPA requires the Secretary to submit the budget of the Nuclear Waste Fund to the Office of Management and Budget (OMB) triennially. The budget of the Nuclear Waste Fund presumably included funding for the Hanford site characterization expenditures during the relevant time period. But there is no evidence in the present record to indicate what specific budget items the Secretary requested, OMB approved and submitted as part of the Budget of the United States Government, and the Congress appropriated, for the period concerned. Without knowing that missing factual information, we cannot analyze whether the undertaking more closely resembled a lump-sum contract, rather than a contract with several subcategories that were separately bargained for and priced, and we cannot decide whether a single B&O tax rate should apply to the overall Hanford site characterization project for purposes of section 116(c)(3). Accordingly, we will remand the "bifurcation" issue to the parties with directions that they submit a joint report to the OHA on the specific budget or budgets that included the money for the Hanford site characterization.

3. Apportionment of BWIP expenditures between Washington and other States

The next issue is whether the BWIP expenditures should be "apportioned" to exclude monies paid to subcontractors lacking a sufficient nexus to Washington State to be subject to the B&O tax. The courts have upheld the broad application of the B&O tax to foreign corporations doing business in Washington. *General Motors Corp. v. Washington*, 84 S.Ct. 1564, 377 U.S. 436, 12 L.Ed.2d 430, rehearing denied 85 S.Ct. 14, 379 U.S. 875, 13 L.Ed.2d 79 (1964). The Supreme Court of the United States concluded in *General Motors* that nexus is established if in-state services are substantial "with relation to the establishment and maintenance of sales, upon which the tax is measured." *General Motors*, 377 U.S. at 447, 84 S.Ct. at 1571. This principle was applied by the Supreme Court of Washington, which held that "It is only when activities in the state are in no way connected with the business taxed that nexus has been found to be absent." *Chicago Bridge*, 98 Wash.2d at 821, 659 P.2d at 468. Unlike the bifurcation question, there is no credible evidence in the record on the apportionment issue that indicates BWIP contractors performed work that was "in no way connected with the business taxed," i.e. the Hanford site characterization. The facts in the present case are similar to the situation in *Chicago Bridge*, and that case is controlling. DOE had the statutory responsibility for the overall Hanford site characterization, and hired subcontractors with the necessary expertise. Some of the BWIP subcontractors had principal places of business that were located outside the State of Washington, and they may have performed work outside Washington, but they were hired to work on the BWIP site characterization. There is no evidence that their functions were not related to the primary task of the BWIP site characterization required by NWPA section 113(a). Consequently, none of the funds that the DOE expended for its subcontractors on the Hanford site characterization should be exempted from the B&O tax for lack of a sufficient nexus under the *Chicago Bridge* case.

4. The time period for PETT eligibility

Our position on this issue was evident in the interlocutory Decision denying RW's Second Motion for Summary Judgment. 28 DOE ¶ 82,501 (2001). The State's original PETT claim for the B&O tax calculated its PETT entitlement by reference to an eligibility commencement date of January 7, 1983, rather than May 28, 1986 when the President approved the BWIP as a candidate site for site characterization as a potential repository. RW correctly points out our determination in the *Benton County* decision that PETT eligibility did not begin until May 28, 1986 when the BWIP was approved as a candidate site under section 112© of the NWPA. *Benton County*, 26 DOE ¶ 80,145 at 80,618 (1996). The State has not submitted any additional evidence or arguments during the course of the present appeal that would lead us to change our prior ruling on the commencement date for PETT eligibility.

In *Benton County*, we determined, *sua sponte*, that the NOIP erred in determining that eligibility for PETT ended on December 22, 1987, the date of enactment of the 1987 NWPA amendments. After reviewing the law, we concluded that PETT eligibility continued for 90 days after that date until March 21, 1988. The relevant part of the 1987 Act, section 160(a) of the NWPA, as amended, provides

> **§ 10172. Selection of Yucca Mountain site**
>
> (a)(1) The Secretary shall provide for an orderly phase-out of site specific activities at all candidate sites other than the Yucca Mountain site.
> (2) The Secretary shall terminate all site specific activities (other than reclamation activities) at all candidate sites, other than the Yucca Mountain site, within 90 days after the date of enactment of the Nuclear Waste Policy Amendments Act of 1987.

42 U.S.C. § 10172. Section 116(c)(3) of the NWPA specifies that PETT grants "shall continue until such time as all [site characterization] activities . . . are terminated at such site." Since termination of site characterization at Hanford was effective 90 days after December 22, 1987, we held that March 21, 1988 was the proper date for termination of PETT eligibility for Benton County. *Benton County*, 26 DOE ¶ 80,145 at 80,618. We disagreed with RW on the termination date for PETT eligibility, and our interlocutory Decision denied RW's Second Motion for Summary Judgment. 28 DOE ¶ 82,501 at 85,003.

RW has asked for reconsideration of our ruling on the termination date for PETT eligibility, and submitted a new legal argument in support of its position. According to RW, section 116(c)(6), which was added by the 1987 NWPA amendments, precluded further "financial assistance" to any State "other than the State of Nevada" after enactment of the NWPA Amendments Act of 1987, and this provision should be read to terminate Washington's PETT eligibility as of December 22, 1987, because it is a "State," rather than a county. In our view, RW has misread the statute, and its argument should be rejected.

As explained above in section *I.A.* of this Decision, section 116(c) of the NWPA provided for two different kinds of grants to States with one or more potential repository sites. Sections 116(c)(1) and (c)(2) provided for "financial assistance" grants to enable the States to participate in the public process leading to the final selection of a repository site. Section 116(c)(3) provided that "The Secretary shall also grant . . . an amount each fiscal year equal to the amount such State and unit of general local government would receive were they authorized to tax such site characterization activities at such site." It is clear under the statute, as originally enacted, and as amended, that PETT grants had a different purpose from financial assistance for participation in the repository selection process. As we noted during the discussion of the legislative history in this Decision and *Benton County*, payments equal to taxes were to ensure "that a State would not be worse off by virtue of having one of these facilities in their State than they would be in terms of taxes. . . ." NOIP, *supra, citing* 128 Cong. Rec. S4132 (April 28, 1982). The statutory language maintains this distinction throughout section 116. The term "financial assistance" is only used in reference to participation by State and affected units of local government in the repository selection process. By contrast, the term "financial assistance" is never used in either the original or the amended version of section 116(c)(3) in reference to payments equal to taxes.

When the 1987 amendments limited the repository selection process to the Yucca Mountain site, section 116(c)(6) terminated the payment of "financial assistance" grants to States other than Nevada as of the effective date of the Act on December 22, 1987. Section 116(c)(6) did not refer to payments equal to taxes. In our reading of the statutory language, the omission of payments equal to taxes from section 116(c)(6) appears to be intentional, since it is consistent with Subtitle E of the 1987 Act, entitled "REDIRECTION OF THE NUCLEAR WASTE PROGRAM," which contained section 160(a), quoted above. 42 U.S.C. § 10172. Under section 160(a) of the amended NWPA, site characterization activities at Hanford were terminated 90 days after enactment of the 1987 Act, on March 21, 1988. Since PETT was to continue until site characterization was terminated at Hanford, it is understandable that there was no mention in section 116(c)(6) of payments equal to taxes ending on the effective date of the 1987 Act. Based on the foregoing analysis, we have concluded that RW has failed to show the State of Washington's PETT eligibility ended before March 21, 1988.

5. Grants for financial assistance to Tribal Governments

There is evidence in the record that the amount of Hanford site characterization budget expenditures that the State used to compute the amount of B&O in its PETT claim included grants that were paid to the governments of Indian Tribes. RW's Hearing Exhibit 6; testimony of Jerry Hammond, *supra*. Federal government grants are generally exempt from the B&O tax, according to the testimony of Donn Smallwood, *supra*, and a DOR pamphlet entitled "Information on the Washington State BUSINESS & OCCUPATION TAX," submitted as State's Hearing Exhibit 8. Even viewing DOE's role in the Hanford site characterization process as that of a general contractor, if the Department's payments to Tribal governments were Federal grants, they do not qualify as site characterization activities under the NOIP, and therefore, should not be counted toward DOE's B&O tax equivalent. The record is inconclusive about the amount of these payments, and we will direct the parties to confer with each other about them and include that information on the joint report which they are to file after receiving this Decision.

V. Conclusion

Based on the foregoing analysis of the record, we have reached the following determinations on the major issues involved in this appeal:

(1) The State of Washington has met its burden of proving that RW's application of the NWPA to the facts of this case, in its Determination to deny the State's PETT claim for the Washington B&O tax, was erroneous in fact and in law, and arbitrary and capricious. We have also determined that the State had the requisite taxing authority under Washington law and tax practice to apply the B&O tax to the Hanford BWIP site characterization, and that it was reasonable and proper on the basis of the entire legal and factual record to use the cost of the BWIP budget expenditures as the basis for calculation of that tax. Thus, we conclude that RW should have granted the State's PETT claim as submitted, subject to certain exceptions noted below.

(2) We are unable to determine whether the entire amount expended for the Hanford BWIP site characterization should have been taxed under the "services" rate, or taxed at different B&O tax rates based on the activities involved. We cannot decide this issue on the basis of the present record because we lack information about the relevant portions of the Federal budget legislation that appropriated funds for site characterization during the period concerned. This information is necessary under the applicable case law to determine whether the budgets for the BWIP site characterization more closely resembled a lump sum contract, or a contract in which specific items were separately valued. If the budget legislation specifically authorized or appropriated separate amounts of money for distinct tasks, it may be proper to "bifurcate" the B&O tax and apply different rates of B&O tax for specific activities.

(3) There has been no showing made under the applicable case law that any part of the overall BWIP expenditure attributable to payments for activities undertaken by DOE's contractors and subcontractors should be "apportioned" between Washington and other States, in which case the amount of B&O tax liability for PETT would have been reduced accordingly.

(4) The period of PETT eligibility should run from May 28, 1986 to March 21, 1988. May 28, 1986 is the date on which the Hanford BWIP became a "candidate site" for site characterization as a possible repository location, and March 21, 1988 is the date on which the Hanford site characterization was effectively terminated under the 1987 amendment to the NWPA.

(5) Grants to Indian Tribal Governments may not be properly included among the costs used to determine DOE's PETT obligation for the B&O tax. We direct the parties to confer with each other and submit a report to supplement the record regarding the grants that were paid to the Tribal Governments under the NWPA, and in what amounts. The basis for calculating the B&O tax liability for PETT should be accordingly reduced.

VI. Reporting Requirements

For the reasons explained above, we are directing the parties to confer with each other, and submit a joint report to the OHA including the following matters: (1) the DOE's treatment of business and income taxes in its PETT settlement with the State of Nevada; (2) the terms of the Federal budget legislation that appropriated funds for the Hanford BWIP site characterization during the period of PETT eligibility; (3) the relevant grants to Indian Tribal Governments; and (4) the recalculation of Washington's PETT claim, based on the period of PETT eligibility determined in this Decision, with interest through July 31, 2002. The joint report should be submitted to the OHA within 45 days of the issuance of this Decision.

VII. Use of Alternative Dispute Resolution

With this determination, OHA has resolved the major legal issues regarding the State of Washington's eligibility for PETT for the B&O tax. We therefore provide a framework for the parties to use for negotiating with each other to reach a final resolution of this matter. There is a precedent in the PETT area for settlements: RW has settled with Nye County, with Nevada, and with Benton County. The Alternative Dispute Resolution Act, 28 U.S.C. § 651, encourages the use of ADR within the Federal court system. The Benton County settlement came about through mediation after a similar Decision by the OHA. The parties should contact the Director of the Office of Dispute Resolution in DOE's Office of General Counsel for assistance in finding a suitable mediator who can assist the parties to resolve remaining issues. The parties will be required to submit a status report to the OHA on the settlement negotiations that we direct them to initiate.

IT IS THEREFORE ORDERED THAT:

(1) The appeal filed by the State of Washington (State) Department of Revenue of the March 23, 1999 Determination by the Department of Energy Office of Civilian Radioactive Waste Management (RW) is hereby granted in part, and denied in part, as set forth in paragraph (2) below.

(2) The March 23, 1999 RW Determination is hereby reversed and set aside, except that:

(a) The period of PETT eligibility for the State shall be May 28, 1986 through March 21, 1988.

(b) Federal grants to Indian Tribal Governments shall not be counted as costs of the Hanford site characterization for purposes of computing the amount of B&O tax for the PETT grant to the State.

(3) No later than 45 days after the date of issuance of this Decision, the parties shall submit a joint report to the Office of Hearings and Appeals, addressing the following matters: (1) the DOE's treatment of business and income taxes in its PETT settlement with the State of Nevada; (2) the terms of the Federal budget legislation that appropriated funds for the Hanford BWIP site characterization during the period of PETT eligibility; (3) the grants to Indian Tribal Governments;

and (4) the recalculation of Washington's PETT claim, based on the period of PETT eligibility determined in this Decision, with interest through July 31, 2002.

(4) This matter is hereby remanded to RW, which shall confer with the State, and within 60 days of the date of this Decision and Order, implement the findings and conclusions set forth herein by issuing a revised determination granting the State PETT based on the Washington Business and Occupation Tax, computed by using the cost of the expenditures for the Hanford site characterization, as if the site characterization had been performed by a private general contractor. The amount of interest on the PETT grant shall be calculated through July 31, 2002.

(5) No later than 75 days after the date of issuance of this Decision and Order, the parties shall submit a joint report to the Office of Hearings and Appeals, explaining their progress toward a final, negotiated resolution on the amount of the State's PETT grant. If for some reason the parties are unable to reach a final resolution on the amount of the State PETT grant before submitting their 75 day report, the Office of Hearings and Appeals will proceed to issue a supplemental order fixing the amount of the PETT grant.

George B. Breznay
Director
Office of Hearings and Appeals

Date: June 25, 2002